Who Owns Your Sweat Equity?

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As we make our way deeper into 2013 with more economic promise in the headlines, it’s a good time to reflect on where we’ve been the last

several years. It was a tough run, but your business or operating division survived the worst recession since the 1930s and is thriving. You were a standout manager and your bonus reflected it. But did your hard work and profit performance convert to accessible, long-term wealth creation for you and your family? If not, someone else owns your sweat equity!

So, how do you unlock the power of ownership and equity and get your annual performance bonus and stock options tied 100 percent to your division’s performance? The answer: Partner with a private equity firm to buy your division (if available), or another business in your supply chain. The business will then serve as a platform investment in a market where you, your leadership team and your new private equity partner have proven track records.

What is a Management Buyout?

For more than 25 years, private equity groups (PEGs) have been active purchasers of businesses in virtually every market. In fact, at this very moment, PE firms are competing with your company’s corporate development department to purchase businesses that may be strategic to your division. In a management buyout (MBO), a management team and private equity firm purchase a company or division from the existing owner (private or corporate).

In many MBOs, the division is a smaller, non-core unit of a larger corporation. With an MBO, managers acquire full authority for the performance of the business and its impact on shareholder wealth without the influence of corporate bureaucracies. This

independence leads to a direct correlation between performance and management wealth creation. In fact, the same operating performance you delivered under a corporate umbrella can produce a significantly better outcome for you and your team after an MBO. In this setting, YOU can own your sweat equity.

You Can Make More Money in an MBO

Consider, for example, a division with $100 million in revenue that earns $10 million in EBITDA (10 percent operating margin). The business is purchased for $50 million (i.e. five times EBITDA), financed with debt (65 percent) from lenders and equity from a PEG (35 percent).

Assume further that revenue grows at 5 percent per year for the next five years with the same EBITDA margin, same working capital ratios and $1 million for annual capital expenditures. That may not seem like a stretch for a top manager, but it showcases how a typical independent business that delivers on a conservative 5-year budget can be quite lucrative for a private equity-backed management team.

In this case, when the business is sold after year five using the same purchase price multiple, $50.9 million in shareholder value is created. In most cases, 10-15 percent of that amount (or $5-$8 million) will accrue to management stock options. In an upside case, where profitability is improved by accelerated revenue growth, margin expansion, capacity utilization and optimized working capital, the value of your stock options could expand even more. One way to accomplish this is through add-on acquisitions where the add-ons are each just half the size of the original platform. In this scenario, management stock option values could expand to $10-$14 million.

As you can see, the same performance you've been delivering over the past few years without the drag of corporate cost allocations and cash flow sweeps produces a very different wealth result for you and your management team.

Take Control

What could you achieve if you had control over strategy, execution and management? What if your board were incentivized in exactly the same way that you were? All of this can be achieved through the purchase of a business in partnership with a private equity group.

The question then becomes, is now the time? Well, according to Bloomberg, 2013 has been the North American Food Manufacturing Group's most active year of mergers and acquisitions (M&A) since 2008. Industry deals in 2013 year to date have totaled $48.7 billion, already above the $42 billion annual Group average since 2008. Packaged foods M&A in North America has been active in 2013, with 21 deals totaling $42.2 billion as of July 3, compared to $36.7 billion for 40 deals during all of 2012. More importantly, U.S. Food Companies represented by the S&P 500 Packaged Foods Index were trading at a 26 percent premium to the S&P 500 Index and 22 percent higher than the five-year average (based on forward price/earnings ratio). Valuations have been boosted by a pickup in M&A activity, and growth in

specialty niches like Organic foods, which are expected to grow by more than 12 percent by 2014, are even more lucrative.

So, if you can see yourself running your own show with a motivated, engaged board of directors, and if you are ready to see just how good you are — it may be time to reach out to a private equity group. The market is ripe. Are you ready to harvest your sweat equity?

Michael Beauregard is Senior Partner and Investment Committee Member at Huron Capital Partners. Founded in 1999, Huron is an operationally-focused private equity firm with a long history of growing lower middle-market companies through customized buy-and-build investment strategies. With over $1 Billon in committed equity capital, Huron has invested in over 65 companies in North America, including several in the food and beverage sectors, that have employed over 7,500 people. For more information, please visit www.huroncapital.com *[1].*

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